

Accounting Questions: Division of an Accounting Practice, Street and Paving Costs

American Institute of Accountants. Bureau of Information

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Accounting Questions

DIVISION OF AN ACCOUNTING PRACTICE

Question: Would you be kind enough to inform me as to the correct procedure to be followed covering the dissolution and division of an accounting practice owned by two certified public accountants.

On April 1st an accounting firm consisting of two certified public accountants will dissolve. It so happens that the partnership has been in existence over 10 years. During all this time clients brought in by each partner have been taken care of by each partner. Clients coming to the firm from recommendation have been taken care of consistently by the partner first interviewing each client. The facts are that partner A is now taking care of clients whose "income values" are far greater than the "income value of clients" taken care of by partner B. What would be the most equitable way of taking care of an exact division of accounting practices in these circumstances? Please understand that clients taken care of by partner A will, in all probability, refuse to make any change in the event that the exact distribution be from an income standpoint.

Answer: Your letter requests advice as to what would be the most equitable way of taking care of the division of the accounting practice of the firm as outlined, at the same time pointing out the fact that a division to which the clients themselves did not agree would not be acceptable to them, and would consequently not be a workable method. It therefore follows that a method of division that is workable may not be equitable to one of the partners.

The only solution in the sort of situation that you describe is apparently for the two partners to sit down and decide as to which of them is to take care of each of their present joint clients and agree between themselves that they will do all in their respective powers to have the clients stay with the accountant who it is mutually agreed is the one best fitted to handle the particular client's affairs.

It may be that one of the present partners will have more clients and a larger practice in this division than the other. However, the chances are that the business is divided in this way at the present time and we can think of no reason why the partner taking the larger clientele should feel that he must make some adjustment with his former partner because of the unequal distribution of clientele at the dissolution of the partnership.

Answer: Your question speaks of an exact division of accounting practices in these circumstances. This seems to ask the impossible, for we do not see how an exact division of accounting practices could be made in any circumstances. Government bonds could be equitably divided, but we do not own our practices; they are not property except in the legal sense that probable future earnings are considered of present value.

Furthermore, if able to make an exact division on an income-producing basis that income might increase, decrease or stop entirely at any time. It is what we shall do, not what we have done, which produces future income.

The partnership in question has much the appearance of a partnership in name only. The essence of an association such as a partnership is that all

individual effort shall work to one combined result and the latter be apportioned in a purely arbitrary but mutually agreed upon manner. The elements that produce true partnership results are too intangible and too indefinable to be measured even approximately.

Net assets originally contributed by the partners may be measurable in the beginning, but if the income division (which is never based on actual individual earnings) differs as between partners the original amounts of net assets contributed may soon lose identity and significance. Original net assets can be exactly apportioned; income can be apportioned by agreement but for daily work and efforts and goodwill there is no exact division.

This being the case all we can do is to suggest the following:

1. If the two partners have, and always have had, a definite understanding as to which clients belong to them settle on that basis however inequitable the result in relative income; or
2. Place the clients' interest ahead of the partners' and divide the work on the basis of which partner can best satisfy that requirement, regardless of the relative income, or
3. Agree upon what seems to be a fair and sensible division exactly as you would on division of profits, giving due consideration to what each partner probably can and will do in respect of his allotted part.

If there is a definite agreement which applies to the situation—apply that; if no such agreement—make one based on equity, reasonableness and probabilities.

Answer: Under the conditions cited it is apparent that the clients, who have been taken care of by partner A, will follow him. As such clients have a larger income value than those who will follow partner B, it is evident that some equitable arrangement must be made to compensate partner B for turning over to A the better part of the profits.

Our suggestion is, therefore, that as between the partners the practice be assigned along natural lines, that is, each partner to take the clients whom he has been serving. A, however, should agree to recompense B over a limited period of time for the excess income value of the clients which he has taken. The situation will call either for an accounting between the two parties of income received, say for a period of three years following dissolution, from the clients taken over by each member of the firm, or a limited accounting on the part of A to B for such portion of the practice as may represent the excess client value. In either event we think that the period for which adjustment payments should be made should be limited to three years. In that event A should agree, after deducting an agreed expense ratio, to divide the excess income or the income from specified clients with B.

In effect this would represent the purchase by A of B's share in the goodwill connected with the excess income producing clients on a three-years' purchase basis. This plan is, of course, flexible and if the partners agree the basis could be a five-year purchase.

I do not see any other equitable way of solving the problem as it is practically impossible to make an even division of the clientele.

STREET AND PAVING COSTS

Question: Kindly advise me if, from an accounting point of view, street and sidewalk paving costs can be capitalized by a city or municipality when paid by the adjacent property owner and no part is paid by the city. I understand that none of the many millions of dollars so paid by property owners in Chicago is capitalized by the city.

My contention is that the property owner who pays for these assessments can capitalize such expenditures, but as the city has paid out nothing this cost can not be capitalized by the city. If so, how should it be credited on the books of the city?

Answer: In the first place, it is of course irrelevant whether the property owner, who pays an assessment for street or paving cost, does or does not capitalize such expenditure.

The question is whether the municipality should capitalize such costs when they are paid, in whole or in part, by the abutters.

When a municipality constructs or improves a highway or a sidewalk it acquires ownership in the property or improvement which is produced. As far as I know the abutters in no instance have any title to such property, even though they may have contributed to the cost. Therefore, the question whether or not the cost of such property should be capitalized is purely an accounting question, depending upon the information which the municipality requires as a basis of financial administration.

In my opinion no part of the costs of highway or pavement improvements should be capitalized.

The capitalization of costs or expenditures means setting up the amounts as resources available to the owner, opposed to liabilities, and thus affecting financial condition, resulting in an increase in surplus or in a decrease in deficit. In my opinion expenditures for highway construction or improvements do not have this direct effect upon financial condition; instead they affect financial condition only, if at all, in an economic not in an accounting sense, by increasing the value of private property subject to taxation.

Nevertheless, records of the cost of such construction should be prepared and retained as an aid to the executive department or to satisfy future inquiry.

The foregoing opinions I hold with reference to all municipal property, with the exception of the properties acquired for carrying on self-supporting activities, such as water-works, street railways, etc. Such properties I believe should be capitalized and subjected to annual write-offs for depreciation just as if they were privately owned, so that the total cost of the service rendered may be determined as a basis for establishing proper service rates.